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ABSTRACT

The New Youth Entrepreneur curriculum is a series of 12 youth-oriented educational modules containing instructional materials, learning activities, and checkup exercises designed to teach students key elements of entrepreneurship. This document is the seventh module, and examines the potential advantages and disadvantages of entering into four different types of business ownership. The first section focuses on sole proprietorships, examining advantages related to the ease of start-up, being the boss, and the ability not to share profits, as well as disadvantages related to individual liability for all debts, the danger of mixing personal and business finances, and difficulty in obtaining loans. The second section discusses advantages and disadvantages of partnerships, while the third section describes corporations and their structure, indicating that they are composed of shareholders, a board of directors, officers, and other employees. This section also describes advantages of corporations, including limited liability, and disadvantages, including increased expenses at start-up and increased taxation on profits. These three sections also provide strategies for avoiding the problems discussed. The final section briefly describes cooperatives and how they differ from corporations. Sample case studies are included. (CELCEE, an Adjunct ERIC Clearinghouse on Entrepreneurship Education) (MAB)

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The New Youth Entrepreneur

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Types of Business Ownership

Module 7

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THE NEW YOUTH ENTREPRENEUR

Types of Business Ownership

Module 7

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Types of Business Ownership

- Types of business ownership
- Sole proprietorship
- Partnership
- The corporation
- The cooperative

Types of Business Ownership

Sole Proprietorship

Partnership

Corporation

Cooperative

- What is each type?
- How do they differ?
- What are the advantages and disadvantages of each type?
- Which is the right one for my business?

Types of Business Ownership

Businesses may be owned in different ways and by differing numbers of people. In this module you will look at these various "forms of ownership" and decide which would be best for your business.

After studying this unit, you will be able to:

1. Describe four forms of business ownership.
2. List advantages and disadvantages of each form.
3. List some ways to minimize some of the disadvantages of each form.
4. Identify the most appropriate form of business ownership for different situations.

Types of Business Ownership

Corey always liked to write poetry. He was very good at it even when he was a young child. He always did very well in his English classes, especially when they did creative writing. Corey decided to use his creative writing skills in the marketplace. He started a business called Corey's Card Creations which developed cards for all occasions. They were very personalized cards. Corey would sit down with the people who wanted cards produced, and have them indicate what types of things they wanted to say to the person to whom the card would be sent. Corey would create a poem which fit the individual and the situation and then use calligraphy to put the poem in the card. The customers would choose the notecards that they wanted to use from a variety of stock which generally had a sketch or drawing on the front of the card.

Corey had a lot of business. Each card took considerable time since he had to compose the poem and then had to write it on the card. Since he wanted to be paid for the time that he put into each card, his cards were much higher-priced than those which customers could purchase in the store. The customers really liked the type of service he provided. But the price seemed to be higher than many consumers in his area wanted to pay.

Corey wondered if he should put in an option of computerization. That is, the verse would be typed onto the card after he developed it. Also, a computer graphics package could be used to develop the front of the cards and even to dress up the inside of the card. He would then not have to purchase the preprinted cards - another savings. He realized that he did not have a computer or the ability to run one for these purposes. Should he look into bringing someone else in as an employee or as a partner?

Corey is really looking at two major decisions. One of them relates to whether he should computerize. The other is whether he wants the form of business ownership to continue as a sole proprietorship or whether he wants his business to follow another form of ownership. This is a very important decision; it can affect your business and you personally in major ways. We will be looking at the various types of business ownership in relationship to what one gains and loses with each type.

Legal Forms of Business Ownership

What FORM of business will you choose?

1. Sole proprietorship
2. Partnership
3. Corporation
4. Cooperative

Each of these "forms of ownership" has benefits and drawbacks. You can decide which way of doing business is best for you.

Sole Proprietorship - What Is It?

A sole proprietorship is a business that is:

- owned by one person
- not a corporation

EXAMPLE: A young man named Will Parker decided to start a business. The name of his business might be:

As a sole proprietor, **you are** the business, even though you call it a different name.

Sole Proprietorship

ADVANTAGES OF BEING A SOLE PROPRIETOR

1. EASY TO GET STARTED

   As with every business:

   - Register the trade name.
   - Apply to the state and federal tax agencies.
   - Secure any needed licenses.

2. YOU'RE THE BOSS

   - NO partners to deal with.
   - NO corporate meetings.
   - NO minute books.
   - NO one's permission or approval to make decisions.

3. LEAST START-UP PAPERWORK

   - NO partnership agreements.
   - NO certificate of incorporation, bylaws, minutes, stock shares.

4. ALL PROFITS ARE YOURS AND THEY ONLY GET TAXED ONCE

   - Proprietor pays taxes on the income that is gained from the business.

Sole Proprietorship

DISADVANTAGES OF BEING A SOLE PROPRIETOR

1. You pay all the bills.

   Because you are the business, you are liable to pay all debts and taxes

   even if the business has losses.

   It is up to you to get the money from somewhere to pay the bills, even your personal savings. This is called unlimited liability.

2. You are limited to your own abilities.

   You have no partners to help you. Everything you do, you do on your own:

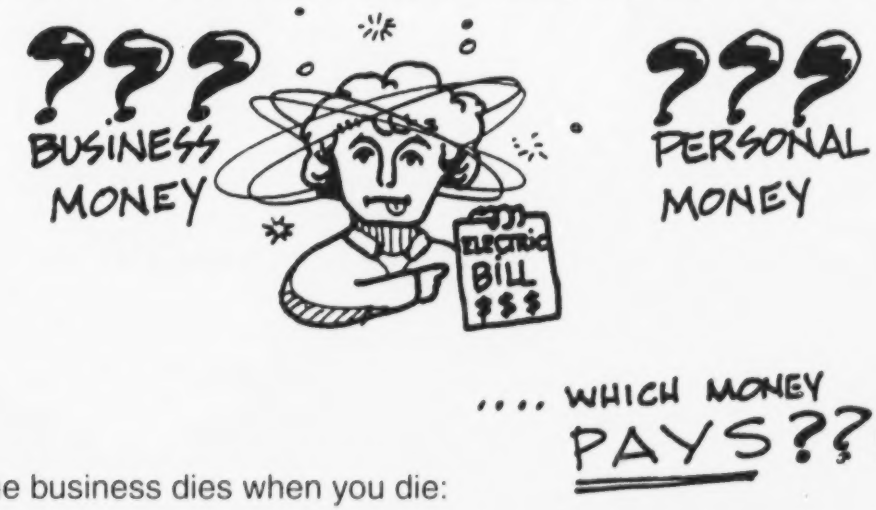
   - Planning.
   - Putting in more money, if needed.
   - No one takes over if you are sick.

Sole Proprietorship

3. It's easy to mix business money with personal money.

   It's easy to use too much business money to pay personal bills.

   It's easy to use too much personal money to pay business bills.



4. The business dies when you die:

   Yes, it can be taken over by someone else, but he/she has to get all the registrations and licenses necessary to start the business again, since it is another person's business, not yours anymore. The business stops, the store gets run down, customers go away.

5. It's tougher to get loans to get started and keep the business going.

   Generally speaking, it is a lot harder to get loans for a one-person operation than for a business involving two or more people.

Sole Proprietorship

WHAT CAN YOU DO TO PREVENT THESE PROBLEMS?

Problem: **You** are responsible for paying **all** the bills!

Solution: Buy Insurance - (disability, liability, medical, etc.) to protect yourself from costs caused by:

- Fire, flood, and other hazards.
- Injuries to other people on your premises.
- Injuries to people on the job site.
- Damage caused by your business cars and trucks.

Problem: You are limited to your own skills and abilities.

Solution: Use Subcontractors - Share parts of the job with other businesses.

Subcontractors are not your employees so you do not have to pay for their insurance. However . . .

Be sure that you have a written agreement with your subcontractors!

Be sure that your subcontractor is insured, too!!!

Sole Proprietorship

Problem: It's easy to mix business money with personal money.

Solution: Cut back on "fun" money to pay your bills on time. Make sure you keep two separate sets of books - personal and business - so that it is not easy to mix up the funds.

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Sole Proprietorship

Check Point! Check Your Understanding

1. Explain four advantages of a sole proprietorship, including why they are advantages.

2. If you were starting a business as a sole proprietorship, indicate which of the advantages would be the most appealing to you. Explain your reply.

3. Explain five disadvantages of a sole proprietorship including reasons why they are disadvantages.

4. What do you believe is the most serious disadvantage of a sole proprietorship? Explain.

5. Indicate how one can alleviate the following problems with a sole proprietorship:

   a. Responsible for paying all bills.

   b. Limited to your own abilities and skills.

   c. Too easy to mix business with personal money.

Partnership - What Is It?

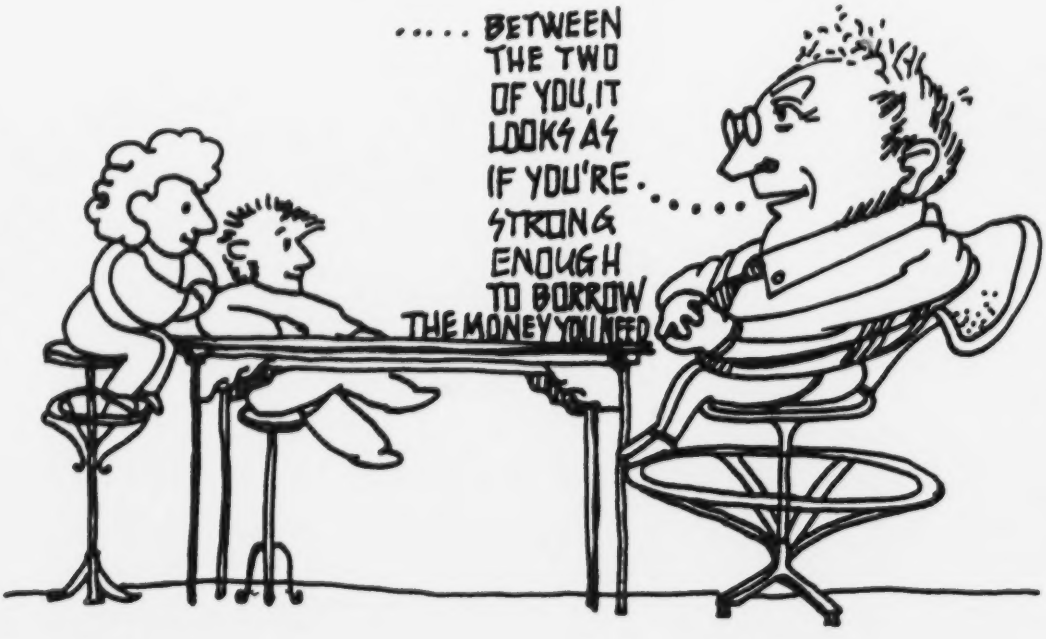
A partnership is a business that is owned by two or more persons, and is not a corporation.

A partnership is put together by contract. You can start a partnership with an oral (spoken) contract, but it is much safer to put it in writing.

Partnership

ADVANTAGES OF HAVING A PARTNERSHIP

1. You are not alone.
   - You can share management problems.
   - Two good people are better than one.
   - There is someone to help plan.
   - There is someone to put in more money, if needed.
   - There is someone to take over if you are sick.
   - There is someone to buy out your share if you want to quit.
   - There is someone to buy out your estate if you die.
   - Loans are generally easier to get because lending agencies are more likely to lend money to a business where two or more people rather than one are behind it.
2. Your combined assets give economic strength and power.



Partnership

3. There is little paperwork to get a partnership started, but you should start with a written agreement.

4. Profits are only taxed once.

   Profits are shared by the partners. Each pays a tax on his/her share of the profits.

DISADVANTAGES OF HAVING A PARTNERSHIP

1. If the partnership business cannot pay its debts or taxes, **each** partner must pay. Partnerships have unlimited liability.

   EXAMPLE: Suppose that Jane Selkirk and Wanda Juarez have a 50/50 partnership. Business has not been good. They bought $10,000 worth of merchandise, none of which sold. They didn't have the money in the partnership to pay the supplier. The partners are legally liable for payment of the $10,000 even if it means dipping into their own personal savings/investments.

2. If one partner goes bankrupt or cannot be found, the other partner is still stuck with the partnership debts.

   Each partner can be held responsible for payment of all business debts.

EXAMPLE: Will Parker and Dave Jones are 50/50 partners. That means they each own half the business. The business owes $3,000 to a paint supplier. Will's partner, Dave Jones, runs off and can't be found.

The paint supplier sues the partnership, and Will and Dave. She wins the lawsuit and the judge says the partnership has to pay her the $3,000.

Partnership

Question: Since Dave cannot be found, does Will have to pay the entire $3,000? (After all, Will only owns half of the business.)

Answer: Yes, Will must pay the entire $3,000.

Question: Is there any way Will can get his money back?

Answer: Yes. Will can sue Dave for half the amount. (That is if Will can find him, and if Dave is worth suing.)

Each partner is responsible for the entire amount of partnership bills.

Partnership

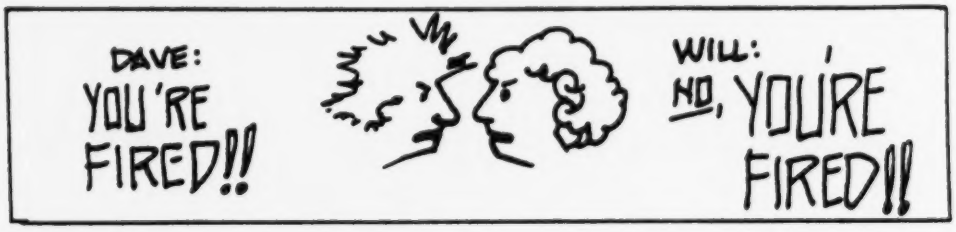
3. Each partner can bind the partnership to contracts without having to get the permission of other partners.

DAVE:
"THAT'S A GREAT PRICE! WE'LL TAKE 3000 GALLONS OF PAINT!!"

WILL:
"WHAT'S HE DOING? WE ONLY USE 400 GALLONS OF PAINT A YEAR!!"

4. It's hard to get rid of a partner.

Your partner is just as much an owner of the business as you are!



5. The death of a partner ends the partnership.

Question: If my partner dies, can't I just go on and run the business by myself?

Answer: Not exactly! If your partner dies, you must either:

a. Buy out your dead partner's share of the business.

or

b. Shut down the business.

or

c. Sell the entire business to someone else if you and the heir of the partner agree.

Partnership

6. You can't sell your share in the partnership to someone else, unless ALL the other partners accept the new partner.

WHAT CAN YOU DO TO CUT DOWN ON THE RISKS OF BEING A PARTNER?

1. Search until you find the right partner.

   The ideal partner:

   a. Has a successful background in business, so he or she can add knowledge and experience to the business.

   b. Knows something about the business you are starting.

   c. Has a good credit rating.

   d. Gets along with you fairly well.

   e. Is a thoughtful, responsible person. You should be able to trust your partner to represent **you** as well as the business.

Remember, you must be just as thoughtful and responsible toward your partner(s) as you expect your partner(s) to be toward you.

Partnership

2. Have a **written** partnership agreement !!

   Your partnership agreement should cover:

   a. The type of business you are starting.

   b. How much money each partner will invest in the business.

   c. When profits will be divided - and how.

   d. Who gets paid for working - and how much.

   e. Job descriptions: who is responsible for doing what jobs; a list of specific responsibilities.

   f. Ways to buy each other out, or to shut down the business peacefully, or to buy out deceased partners.

   g. Ways for letting other partners into the business.

   h. Limits on the buying power of individual partners.

3. Do the same things you would do if you were a Sole Proprietor:

   a. Have enough insurance.

   b. Use subcontractors.

   c. Separate business from pleasure.

You and your partners should understand each of the items in the written partnership agreement <u>before</u> you go into business together!

Partnership

Check Point! Check Your Understanding

1. Explain the difference between a partnership and a sole proprietorship.

2. Describe four advantages of a partnership form of business organization.

3. React to the following statement: "Since the law does not require a written partnership agreement for a partnership to exist, it is really not necessary to develop one."

4. Describe six disadvantages of a partnership.

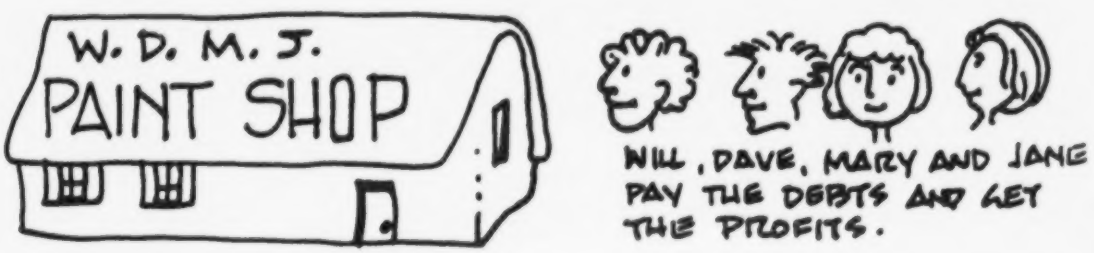
5. What qualities would you look for in someone who would be an effective partner?

The Corporation - What Is It?

A corporation is a separate legal person. Look at how it is different from a sole proprietorship or a partnership:

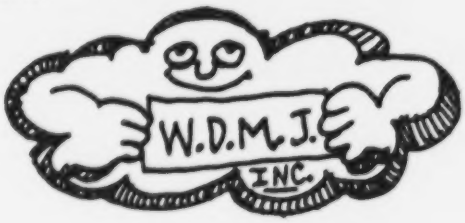
A sole proprietorship is a person (Will Parker) doing business.

A partnership is a group of persons (2 or more) doing business.



The Corporation

Legally, a corporation acts like a person owned by other people. The big difference in a corporation is that the corporation and its owners are distinctly different.



THE CORPORATION (WDMJ.) IS THE "PERSON" TO SUE WHEN THE BILLS ARE NOT PAID. THE CORPORATION MAKES THE PROFITS.

Question: How does a corporation operate?

Answer: A corporation operates through four different kinds of people. (Sometimes one or two individuals will do the work of all four kinds.)

☆ ① SHAREHOLDERS = THE OWNERS

☆ ② MEMBERS OF THE BOARD OF DIRECTORS = SET THE POLICY and DIRECTION.

☆ ③ OFFICERS

A. PRESIDENT
B. VICE PRESIDENT
C. SECRETARY
D. TREASURER.

} THESE ARE EMPLOYEES WHO RUN THE COMPANY.

☆ ④ OTHER EMPLOYEES:

[FOREMAN, TRUCKDRIVER, PAINTERS, ETC., ETC.]

The Corporation

1. THE SHAREHOLDERS :

   a. Own the corporation.

   b. Invest (give) money to make the corporation go.

   c. Get certificates of shares or stock certificates telling how many shares of stock they own. They get these shares in exchange for the money they invested in (gave to) the corporation.

   d. Elect the members of the board of directors.

   e. Collect their share of the profits from the corporation. These profits are called "dividends".

      Note: If you do not have a stock certificate in your name, you are not an owner (shareholder) in the corporation. Only shareholders can collect dividends.

   f. Lose the money they have invested if the corporation fails (goes broke). But, all they can lose is the amount of money they invested in the corporation. They personally do not have to pay the corporation's debts.

      EXAMPLE: Sally buys 100 shares of XYZ Corporation for $10,000. XYZ goes bankrupt (fails, goes broke) and still owes $1 MILLION in debts.

      Question: Since Sally is an owner (shareholder) of the XYZ Corporation, does she have to help XYZ pay its $1 million debt?

      Answer: No.

      Question: How much can Sally lose ?

      Answer: Sally may lose the whole $10,000 she invested in XYZ Corporation, but that is all she can lose.

   g. Get one vote per share for elections of shareholders and on important policy issues.

The Corporation

2. THE DIRECTORS:

   a. Are elected by the shareholders to represent them.

   b. Decide what business the corporation will carry out.

   c. Plan how the corporation will do business.

   d. See that the officers carry out the plans properly.

   e. As a group are known as the Board of Directors.

SHALL WE LEASE THE PAINTSHOP BUILDING OR BUY IT?
WHAT ARE OUR SALES GOALS THIS YEAR?
ARE WE CARRYING OUT THE SHAREHOLDER'S WISHES?!
SHOULD WE KEEP THE PRESIDENT??

3. THE OFFICERS :

   a. Are employees of the corporation.

   b. Carry out the plans of the directors.

   c. Report on progress to the directors.

   d. See that the work and business of the corporation get done. (This means they are in charge of operations.)

4. OTHER EMPLOYEES

   a. Do the rest of the corporation's work.

   b. Report to the officers.

The Corporation

ADVANTAGES OF A CORPORATION

1. Limited Liability

   The debts are the responsibility of the Corporation, **not** of the individual owners (stockholders).

2. It is easy to change ownership.

   The corporation does not "die" like the partnership and sole proprietorship, when the business changes owners.

   EXAMPLE: Will decides to sell his 25 shares in WDMJ Paint Shop, Inc. He will sell them to Mrs. Jackson for $10,000.

   After the sale, Mrs. Jackson joins Dave, Mary and Jane as a shareholder. The corporation keeps going.

WDMJ INC.
COME IN WE'RE OPEN
WILL: "I'LL SELL YOU MY 25 SHARES OF THE CORPORATION FOR $10,000!"
MRS. JACKSON: "O.K. HERE'S THE $10,000. NOW LET ME GET THESE SHARES TRANSFERRED INTO MY NAME!"

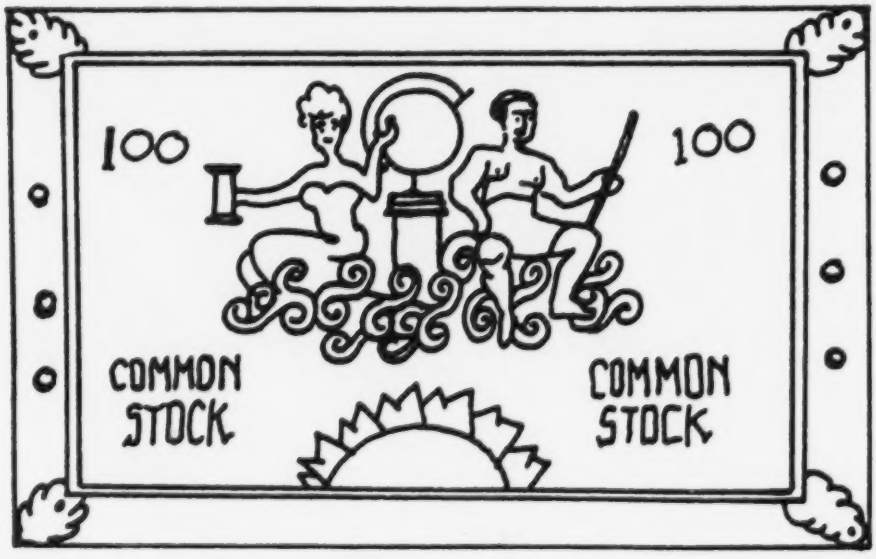
The Corporation

3. The corporation continues to live after the death of a shareholder.

   If a shareholder dies, the corporation does not have to start all over again. The deceased shareholder's stock becomes owned by his/her heirs. In some cases they are sold back to the corporation or the other shareholders.

4. Sometimes it is easier for a corporation to raise capital.

   The corporation can offer to sell a "piece of the company" (shares of stock) to investors.



DISADVANTAGES OF A CORPORATION

1. Corporations are more expensive to organize.

   Corporations are created by paperwork. Hiring the right people to do the paperwork correctly costs money.

   Question: What kinds of paperwork are needed to form a corporation?

   Answer:

   a. Corporate Certificate - (Certificate of Incorporation: Corporate Charter) - To start a corporation you must file a Corporate Certificate with the Secretary of State of the state where the business will be located.

   b. By Laws -Tell how important decisions are going to be made and must be approved by the shareholders or the directors.

   c. Resolutions and Consents - Important decisions (such as leasing or buying buildings or expensive equipment) which are put in writing, so that everyone knows what the corporation decided to do.

   d. Minutes - A written record of all shareholders' and directors' meetings.

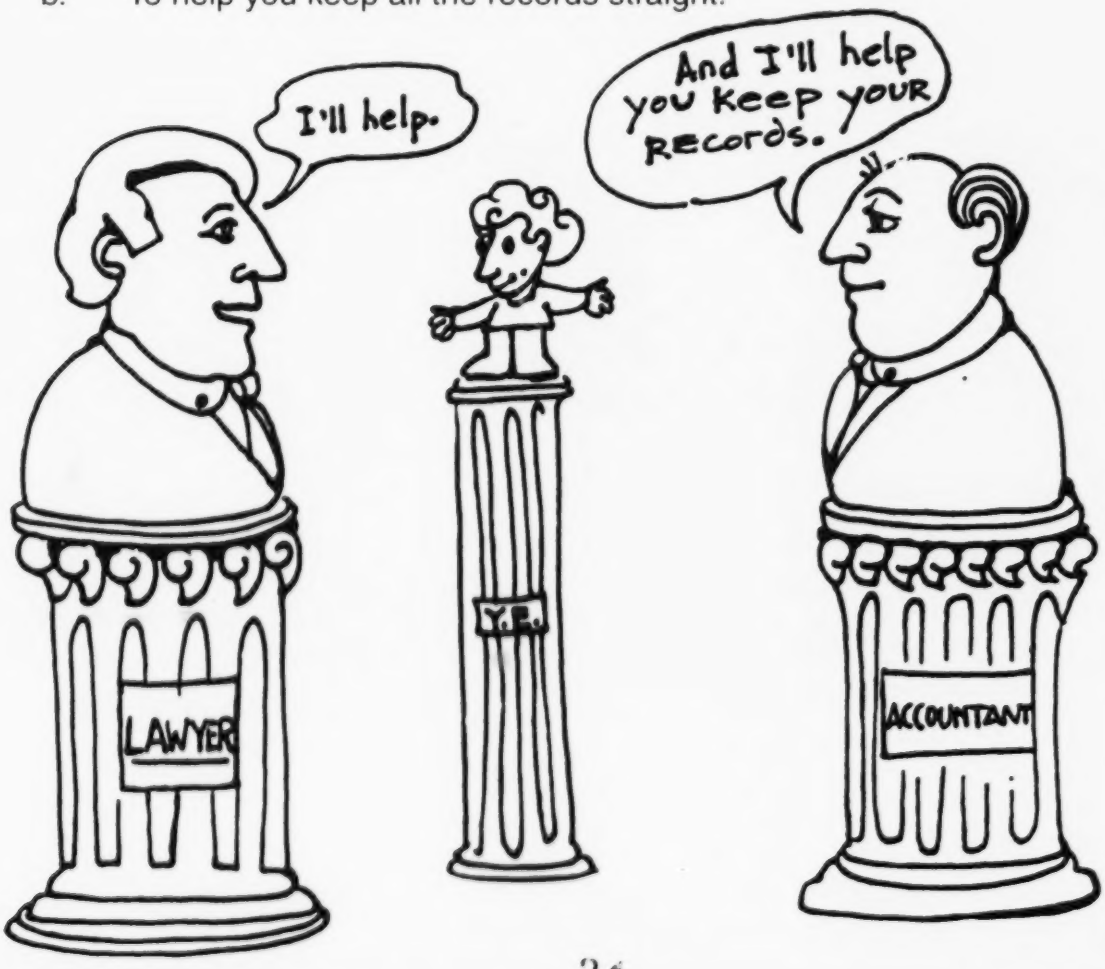
...DOES THE CERTIFICATE OF INCORPORATION ALLOW THE COMPANY TO GO INTO THE PAINT-SHOP BUSINESS?
CERTIFICATE OF INCORPORATION
BYLAWS
MINUTES
.... LET'S LOOK IN THE BYLAWS TO SEE IF WE HAVE ENOUGH MEMBERS TO VOTE.
-DIDN'T WE ALREADY AUTHORIZE THE COMPANY TO BUY THE SHOP? LETS LOOK IN THE PAST MINUTES.

2. Profits are taxed twice.

   Since the corporation is like a person, its income is taxed. The income distributed to shareholders by the corporation is also taxed as personal income to each party.

WHAT CAN YOU DO TO CUT DOWN ON THE RISKS OF OWNING AND RUNNING A CORPORATION?

1. Do the same things you would do for a sole proprietorship:
   a. Buy insurance.
   b. Use subcontractors.
   c. Separate business from pleasure.
2. Use a business lawyer and an accountant:
   a. To help you understand how corporations work.
   b. To help you keep all the records straight.



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3. Use a shareholder agreement (sometimes called a buy/sell agreement).

   In a small corporation, shareholders may want to keep each other from selling their shares to outsiders. A shareholder agreement can help you keep control of who owns stock.

   The shareholder agreement might:

   a. Restrict the sale of stock. The shareholders can agree, in advance, not to sell to outsiders unless they first give the corporation and other shareholders the chance to buy their shares.

WILL:
IM SICK OF ALL THESE DISAAREEMENTS! IM GOING TO SELL MY SHARES TO MRS. JACKSON.
DAVE:
YOU CAN'T DO THAT! OUR SHAREHOLDER AGREEMENT SAYS YOU HAVE TO OFFER THEM TO THE OTHER SHARE HOLDERS AND TO THE CORPORATION FIRST!

   b. Guarantee each shareholder a seat on the board of directors.

   c. Describe job responsibilities of certain shareholders who work for the corporation.

   d. Set higher voting requirements for major decisions.

      EXAMPLE: Normally for XYZ, Inc. if 51 percent of the shareholders agree, a vote passes.

      However, in the shareholder agreement, XYZ, Inc. has the rule that if the corporation shareholders were voting on a VERY IMPORTANT ISSUE like selling the company or buying up another company, 80 percent of the shareholders must agree for the vote to pass.

e. Set guidelines for issuing more shares of stock.

f. Set the price of shares of stock, in case someone wants to sell his or her shares, or in case a shareholder dies.

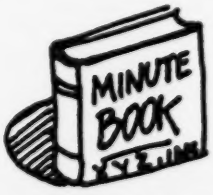
4. Treat your corporation at all times as a separate legal person!

This means following all the rules for running a corporation!

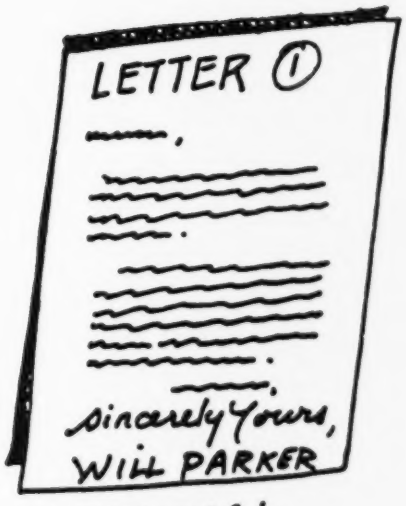
a. Hold shareholder meetings where directors report on progress, and shareholders tell the directors of any changes they want.

b. Hold directors' meetings where officers report on progress, and directors tell the officers of any changes they want.

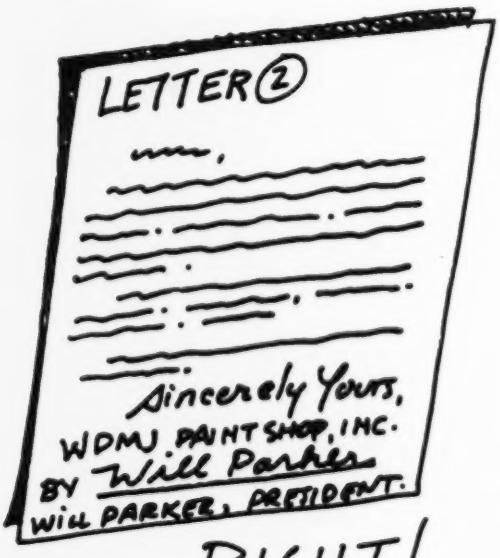
c. Keep minutes (written records) of what happens at these meetings, and what decisions are made.



d. Sign all documents and checks in the corporation's name.



WRONG!



RIGHT!

IF IN DOUBT,
HAVE YOUR LAWYER
SHOW YOU HOW TO PROCEED!

The Corporation

Check Point! Check Your Understanding

1. Comment on the statement that a corporation is a separate person. What does that mean?

2. Name and describe the four separate groups of people who operate a corporation. In your answer show how they relate to each other as far as the responsibilities that they have.

3. Name four advantages of a corporation.

4. Name two disadvantages of a corporation.

5. Describe what is included in a shareholder agreement.

What Is a Cooperative?

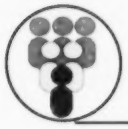
A cooperative is a special type of business. Instead of stockholders who own the business through investing in the corporation, a cooperative is owned, and in many cases operated, by its members.

Basically, a cooperative is made up of individual businesses who join together to market their goods or services, to reduce their costs, or in some other way to *benefit from cooperating.*

For example, Will's Paint Shop might join with Marilyn's Weekend Kids Kamps, John's Bed & Breakfast for Pets, and Sheila's Video Productions in a "Teen's Business Services Cooperative." The cooperative could market the businesses, with each business sharing the costs of a display ad in a local paper and a radio spot. The cooperative might hire one or two employees to take orders and set appointments for all the member businesses. The cooperative might purchase office supplies in large quantities — at lower prices than the individual businesses could do separately.

Usually, cooperatives are formed by businesses which produce similar products. The most common cooperatives are those for agricultural products, such as grains, fruits or vegetables. A farmers' market which is open every weekend with produce being brought in by farmers is one example. However, there are many other business cooperatives as well.

Cooperatives are different from corporations in another important way. The goal of a corporation is to earn profits for its stockholders; the goal of a cooperative is to provide benefits for its members.



Types of Business Ownership

Anna was a 16 year-old who thoroughly enjoyed the outdoors. She went camping every time she had a chance. She lived in an area which had a lot of hills, lakes and forests - perfect for her camping interests. She found that a lot of other students liked camping as well, so she decided to set up a small business called Anna's Adventures, which would put together camping trips ranging from one to seven days in length. She planned and organized them, including doing the advertising, renting the equipment, hiring the adult leader, and collecting the money. On some of the longer trips, she would generally go along as an assistant guide.

After one year of operation, Anna made the following observations about her business:

1. The demand for the trips was not being met; she had to turn down people who wanted to go on them since she limited the size to 10-15 people per trip. She estimated that she could double her business if she had more people to plan, organize, and lead the trips. Or she could double the number of people allowed to go on each trip.

2. Profits last year were $3,600, which is quite good considering that this was a part-time job.

3. The camping gear used for the campsites was beginning to look a little tired. Some replacements would need to be made.

4. She was running out of new ideas for camping trips. She was concerned that some people would not take many more trips with her because there wouldn't be any more "new" trips that she would be offering.

Types of Business Ownership

Anna was thinking very seriously about adding a partner to her business. Currently her business is a sole proprietorship. Help her make some decisions in regard to this situation by answering the following:

a. Name some specific advantages to Anna which could be achieved if she brought aboard a partner about her age. About her parents' age.

b. Name some disadvantages of her changing to a partnership form of ownership for her business.

c. What would you do if you were Anna? Would you stay with a sole proprietorship or would you add a partner to the business? Explain.

d. Would your answer to the above be different if Anna found out that a local community organization, such as the YMCA, started to offer camping programs at a fairly inexpensive price?

Types of Business Ownership

Check Point! Check Your Understanding

1. Many of the advantages and disadvantages of a sole proprietorship and partnership are the same. List those advantages and disadvantages.

2. What is meant by unlimited liability and how does that principle relate to sole proprietorships, partnerships and corporations?

3. Why is there more paperwork in establishing a corporation than with a sole proprietorship or a partnership?

4. How are a stock certificate, by-laws of a corporation and a shareholder's agreement different?

Types of Business Ownership

5. Describe and compare the ways money is raised by sole proprietorships, partnerships and corporations.

6. What are some ways to reduce the problems arising from unlimited liability that you find with a sole proprietorship or a partnership?

7. Some people have commented that corporations are run to some extent like our representative government. Why is that statement true or false?

8. Why does a corporation not die when one of the owners dies, but a sole proprietorship or partnership does die?

9. What are two differences between a cooperative and a corporation?

10. For each of the following business ventures, indicate which form of business organization would probably be best. Be sure to give reasons for your responses.

    a. a new local delivery service

    b. a new automobile company

    c. a new computer manufacturer

    d. a new software development firm

    e. a new top-of-the-line men's clothing store

    f. a market where farmers could sell their own produce